

State of Florida



## Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD  
TALLAHASSEE, FLORIDA 32399-0850

### -M-E-M-O-R-A-N-D-U-M-

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**DATE:** June 5, 2009

**TO:** Office of Commission Clerk (Cole)

**FROM:** Division of Economic Regulation (Slemkewicz, Maurey)  
Office of the General Counsel (Fleming, Klancke)

**RE:** Docket No. 090145-EI – Petition for expedited approval of the deferral of pension expenses, authorization to charge storm hardening expenses to the storm damage reserve, and variance from or waiver of Rule 25-6.0143(1)(c), (d), and (f), F.A.C., by Progress Energy Florida, Inc.

**AGENDA:** 06/16/09 – Regular Agenda – Proposed Agency Action – Interested Persons May Participate

**COMMISSIONERS ASSIGNED:** All Commissioners

**PREHEARING OFFICER:** McMurrian

**CRITICAL DATES:** 06/29/09 (90-Day Suspension Date)

**SPECIAL INSTRUCTIONS:** None

**FILE NAME AND LOCATION:** S:\PSC\ECR\WP\090145.RCM.DOC

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### Case Background

On March 20, 2009, Progress Energy Florida, Inc. (PEF or Company) filed a petition seeking the expedited approval of the deferral of pension expenses, the authorization to charge storm hardening expenses to the storm damage reserve, and the waiver of Rule 25-6.0143(1)(c), (d), and (f), Florida Administrative Code (F.A.C.) (Petition). The Company is engaged in business as a public utility providing electric service as defined in Section 366.02, Florida Statutes (F.S.), and is subject to the jurisdiction of the Commission. PEF's service area comprises approximately 20,000 square miles in 35 of Florida's counties. PEF serves more than 1.6 million retail customers.

PEF is requesting a \$52,476,667 (\$57,216,480 system) deferral of the increase in its retail pension expense between 2008 and 2009. The \$52,476,667 represents the difference between PEF's 2009 projected pension expense of \$31,067,401 (\$33,873,480 system) and its 2008 pension income of \$21,409,266 (\$23,343,000 system). PEF is further requesting that the deferral be allowed to continue until such time as the recovery of these costs is included in base rates at some unspecified future date.

PEF is also requesting a waiver of Rule 25-6.0143, F.A.C., to allow it to charge a projected amount of \$33,072,573 (\$36,109,276 system) of regular storm hardening distribution and transmission O&M expenses and depreciation expense to the storm damage reserve rather than to normal operating expenses. The \$33,072,573 represents O&M expenses of \$31,723,377 (\$34,361,078 system) and depreciation expense of \$1,349,196 (\$1,748,198 system). A waiver is required because the rule specifically states that only incremental storm-related restoration costs are to be charged to the storm damage reserve.

On April 3, 2009, the Office of Public Counsel (OPC), the Florida Industrial Power Users Group (FIPUG), the Attorney General's Office, The Florida Retail Federation (FRF), and PCS Phosphate (collectively, Intervenors) filed a joint consolidated response opposing three PEF filings: (1) a request for interim rate relief, (2) a petition related to the accounting treatment for pension and storm hardening expenses, and (3) a petition for limited proceeding to include the Bartow Repowering Project in base rates. On April 8, 2009, the parties and staff met to discuss the Intervenors' joint consolidated response. At the meeting, staff noted that while a response to a response is not normally contemplated by the Commission's rules, it might be helpful for PEF to file some additional clarifying comments regarding the Intervenors' response. The Intervenors did not object to staff's request at that time, nor have they filed an objection to PEF's response. PEF filed a response to the joint intervenors consolidated response on April 15, 2009.

This recommendation addresses the deferral of the pension expense and the waiver of Rule 25-6.0143, F.A.C. The Commission has jurisdiction over this matter under Sections 366.04 and 366.05, F.S.

### **Discussion of Issues**

**Issue 1:** Should the Commission grant Progress Energy Florida, Inc.'s request for a waiver of Rule 25-6.0143(1)(c), (d), and (f), F.A.C.?

**Recommendation:** No. The Commission should not grant a waiver of Rule 25-6.0143(1)(c), (d), and (f), F.A.C. (Fleming, Klancke)

### **Staff Analysis:**

#### **PEF's Petition**

In its Petition, PEF requests a waiver of Rule 25-6.0143(1)(c), (d), and (f), F.A.C., to allow it to charge its expenses in 2009 for the Commission's storm hardening initiatives to the Storm Damage Reserve. PEF contends that a rule variance or waiver is appropriate when (1) the purpose of the rule will otherwise be satisfied even though the rule is waived and (2) substantial hardship of a technological, economic, legal, or other nature will result from compliance with the rule. See Section 120.542(2), F.S. PEF asserts that the waiver of these provisions of the Storm Damage Reserve Rule in this instance satisfies both prongs of Section 120.542(2), F.S. In particular, PEF asserts that the underlying purpose of the Storm Damage Reserve Rule provisions are otherwise satisfied because PEF's incremental storm hardening initiative expenses advance the same purpose as the rule by preventing storm damage and weather-related outages that would necessitate the use of resources to restore electric service. PEF further asserts that its compliance with the legislative and Commission-mandated storm hardening initiatives require PEF to incur expenses at a time when utility operation and maintenance costs continue to increase but sales revenues to the utility are diminishing. As a result, PEF argues that its sales are not covering all required costs of service in 2009 and thus, PEF faces a substantial economic hardship without a rule waiver.

#### **Intervenors' Consolidated Response**

The Intervenors object to PEF's request for a waiver. The Intervenors assert that PEF has failed to meet the statutory standards contained in Section 120.542(2), F.S. The Intervenors contend that the waiver cannot be granted because PEF has not demonstrated that the purposes of the Storm Damage Reserve Rule would be met by charging tree trimming and pole inspections costs against the Storm Damage Reserve. They argue that the Storm Damage Reserve would never have been created if allowable expenses were not strictly limited to storm recovery and service restoration. According to the Intervenors, PEF's current request to charge non-storm related costs against the Storm Damage Reserve directly contradicts these representations.

The Intervenors further contend that PEF's Petition for waiver should also fail because PEF has not established the existence of a substantial hardship resulting from compliance with the rule. In particular, the Intervenors assert that PEF's primary argument for waiver is grounded in the erroneous notion that PEF has a right under the Stipulation to earn at least a 10 percent

return on equity (ROE).<sup>1</sup> The Intervenors contend that PEF's assertion that a substantial financial hardship exists is little more than a complaint that PEF cannot live up to the deal it made in the Stipulation, in that PEF has argued that the frozen rates are making it hard to cover these types of storm hardening costs. Therefore, the Intervenors assert that the Commission should dismiss any claims for relief or waiver, and PEF's proposal should be denied.

### PEF's Response to Joint Intervenors' Consolidated Response<sup>2</sup>

On April 15, 2009, PEF filed its response to the Intervenors' joint consolidated response. PEF contends that the Commission should grant PEF's requested waiver of Rule 25-6.0143(1)(c), (d), and (f), F.A.C., because the new storm hardening initiatives advanced by the legislature and the Commission have imposed new costs upon PEF to achieve regulatory objectives that are consistent with restoration of service through the Storm Damage Reserve, as explained in detail in PEF's Petition. PEF asserts that even the Intervenors concede that "[s]torm hardening costs like those for tree trimming and pole inspection are somewhat, but not exclusively related to making the property resistant to hurricane damage . . . ." Thus, PEF asserts that its request for rule waiver is appropriate.

### Analysis

Section 120.542, F.S., sets out the criteria that must be met before the Commission can grant a rule waiver. Subsection (2) of the statute provides:

Variations and waivers shall be granted when the person subject to the rule demonstrates that the purpose of the underlying statute will be or has been achieved by other means by the person and when application of a rule would create a substantial hardship or would violate principles of fairness. For purposes of this section, "substantial hardship" means a demonstrated economic, technological, legal, or other type of hardship to the person requesting the variance or waiver. For purposes of this section, "principles of fairness" are violated when the literal application of a rule affects a particular person in a manner significantly different from the way it affects other similarly situated persons who are subject to the rule.

Thus, a rule variance or waiver is appropriate when (1) the purpose of the statute will be otherwise satisfied even though the rule is waived and (2) substantial hardship of a technological, economic, legal, or other type of hardship will result from compliance with the rule, or compliance would violate principles of fairness. See Id.; see also Panda Energy Int'l v. Jacobs, 813 So.2d 46, 51 (Fla. 2002).

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<sup>1</sup> Section 7 of the Stipulation provides "[i]f PEF's retail base rate earnings fall below a 10 [percent] return on equity as reported on a Commission adjusted or pro-forma basis on a PEF monthly earnings surveillance report during the term of the Agreement, PEF may petition the Commission to amend its base rates notwithstanding the provisions of Section 4, either as a general rate proceeding or as a limited proceeding under Section 366.076, F.S."

<sup>2</sup> The Commission's rules do not contemplate a response to a response; however, a response providing additional information from PEF was requested at the April 8, 2009, informal meeting, attended by all the parties. No objection has been filed to PEF's response.

The statutory provisions underlying this rule are Sections 350.115 and 366.04(2)(a), F.S. Section 350.115, F.S., provides:

350.115 Uniform systems and classifications of accounts.--The commission may prescribe by rule uniform systems and classifications of accounts for each type of regulated company and approve or establish adequate, fair, and reasonable depreciation rates and charges.

In addition, Section 366.04(2)(a), F.S., provides that in the exercise of its jurisdiction, the Commission shall have the power “[t]o prescribe uniform systems and classifications of accounts.” Both statutes provide the Commission with authority to prescribe uniform systems and classifications of accounts.

PEF’s Petition does not address whether the purposes of the statutes underlying the rule will be otherwise satisfied. PEF’s analysis is directed at whether the purposes of the Storm Damage Reserve Rule are otherwise satisfied by their compliance with the Storm Hardening Rule. Staff does not believe that this is the appropriate analysis under Section 120.542, F.S. Staff believes that the appropriate analysis is whether the purpose of the underlying statutes have otherwise been satisfied. The purpose of the underlying statutes is to allow the Commission to establish the criteria for uniform systems and classifications of accounts. In this case, Rule 25-6.0143(1)(c), (d), and (f), F.A.C., establishes the criteria for making charges to the uniform systems of accounts, Account No. 228.1, Accumulated Provision for Property Insurance. In its Petition, PEF has not demonstrated that the purpose of the statutes underlying this rule will be or has been achieved by other means.

Rule 25-6.0143(1), F.A.C., clarifies that the Storm Damage Reserve is “to provide for losses through accident, fire, flood, storms, nuclear accidents and similar type hazards to the utility’s own property or property leased from others, which is not covered by insurance.” Both PEF and the Intervenors concede that the Storm Damage Reserve is a utility resource that supports the funding of immediate restoration activity following severe weather events without undermining the financial integrity of the utility. See Rule 25-6.0143(1)(e), F.A.C. (allowing for a wide range of storm-related costs to be charged to the Storm Damage Reserve). Rule 25-6.0143(1)(f), F.A.C., expressly prohibits a utility from charging certain operation and management expenses to the Storm Damage Reserve that are not related to any accident, fire, flood, storms, nuclear accidents, and similar type hazards. The types of expenses PEF seeks to charge against the Storm Damage Reserve do not fall into the category of costs that may be charged to the account as established by the rule. The purpose of the rule is to standardize the way investor-owned electric activities account for damage to utility property from extreme weather events. Staff does not believe that approving the depletion of the Storm Damage Reserve at the beginning of the 2009 hurricane season would serve to meet the purpose of the rule or the underlying statute.

Furthermore, staff does not believe that PEF has sufficiently established that a substantial hardship of a technological, economic, legal, or other type of hardship will result from its compliance with the rule. See Section 120.542(2), F.S. PEF has asserted that its compliance

with the legislative and Commission-mandated storm hardening initiatives require PEF to incur expenses at a time when utility operation and maintenance costs continue to increase, but sales revenues to the utility are diminishing. As a result, PEF contends that its sales are not covering all required costs of service in 2009, and PEF faces a substantial economic hardship without a waiver.

PEF's argument seems to be based upon the premise that, if it must comply with the requirements of the Storm Hardening Rule during a period of diminishing sales revenues, and it is denied the ability to deplete the Storm Damage Reserve, then an unforeseen substantial economic hardship will result. Staff simply does not believe that the requirements of the Storm Hardening Rule, in the absence of a corresponding depletion of the Storm Damage Reserve, constitutes a substantial economic hardship to the utility.

Moreover, at the Agenda Conference on May 19, 2009, the Commission approved approximately \$144 million in rate relief in Docket Nos. 090079-EI and 090144-EI, cumulatively. Staff believes that such rate relief has effectively mitigated PEF's assertion that, absent the depletion of the Storm Damage Reserve resulting from the waiver sought, PEF's compliance with the requirements of the Storm Hardening Rule will create a substantial economic hardship to the utility.

For the foregoing reasons, staff does not believe that PEF has demonstrated that the purpose of the statute underlying this rule will be or has been achieved by other means nor has PEF demonstrated that application of the rule will create a substantial hardship for PEF. Therefore, staff recommends that the Commission should deny Progress Energy Florida, Inc.'s request for a waiver of Rule 25-6.0143(1)(c), (d), and (f), F.A.C.

**Issue 2:** If the rule waiver is granted in Issue 1, should the Commission authorize Progress Energy Florida, Inc. to charge any of its 2009 storm hardening expenses against the Storm Damage Reserve?

**Recommendation:** No. PEF should not be authorized to charge any of its 2009 storm hardening expenses against the Storm Damage Reserve. If the Commission approves staff's recommendation in Issue 1, this issue is moot. (Slemkewicz)

**Staff Analysis:** PEF has undertaken certain infrastructure storm hardening activities to strengthen its transmission and distribution facilities to better withstand the effects of extreme weather conditions, such as hurricanes. These activities include such items as vegetation management and wood pole inspection and replacement. During 2009, PEF projects that it will incur \$33,072,573 (\$36,109,276 System) of regular storm hardening distribution and transmission O&M expenses and depreciation expense. The \$33,072,573 represents O&M expenses of \$31,723,377 (\$34,361,078 system) and depreciation expense of \$1,349,196 (\$1,748,198 system). PEF has requested that it be authorized to charge these normal operating expenses, unrelated to storm restoration activities, to the storm damage reserve.

Rule 25-6.0143(1), F.A.C., states in part:

(1) Account No. 228.1 Accumulated Provision for Property Insurance.

(a) This account may be established to provide for losses through accident, fire, flood, storms, nuclear accidents and similar type hazards to the utility's own property or property leased from others, which is not covered by insurance....

(b) ....

(c) ....

(d) In determining the costs to be charged to cover storm-related damages, the utility shall use an Incremental Cost and Capitalization Approach methodology (ICCA). Under the ICCA methodology, the costs charged to cover storm-related damages shall exclude those costs that normally would be charged to non-cost recovery clause operating expenses in the absence of a storm. Under the ICCA methodology for determining the allowable costs to be charged to cover storm-related damages, the utility will be allowed to charge to Account No. 228.1 costs that are incremental to costs normally charged to non-cost recovery clause operating expenses in the absence of a storm. All costs charged to Account 228.1 are subject to review for prudence and reasonableness by the Commission. In addition, capital expenditures for the removal, retirement and replacement of damaged facilities charged to cover storm-related damages shall exclude the normal cost for the removal, retirement and replacement of those facilities in the absence of a storm. The utility shall notify the Director of the Commission's Division of Economic Regulation in writing for each incident expected to exceed \$10 million.

The Storm Damage Reserve Rule clearly states that the purpose of the Storm Damage Reserve is to provide for incurred and uninsured losses related to various hazards such as storms. The rule also provides that the costs charged for storm-related damages shall exclude costs that would normally be charged to operating expenses in the absence of a storm. PEF argues that the storm hardening activities serve to avoid or reduce storm-related damage, and match the reason for the Storm Damage Reserve. PEF then reasons that the expenses associated with the avoidance of a potential loss are akin to the incurrence of an actual loss.

In this docket, PEF is seeking to reduce its Storm Damage Reserve by \$33.1 million at the beginning of the 2009 hurricane season. In its current rate case in Docket No. 090079-EI,<sup>3</sup> PEF is requesting a \$16 million annual accrual to its Storm Damage Reserve, a \$10 million increase over the current annual accrual of \$6 million. The Company contends that the \$16 million annual accrual is necessary to establish a Storm Damage Reserve balance that will be adequate to cover most expected losses during future storm seasons.<sup>4</sup>

An inadequate Storm Damage Reserve balance can result in additional charges to the ratepayers. For example, Order No. PSC-05-0748-FOF-EI<sup>5</sup> authorized a 2-year surcharge, beginning in August 2005, to recover \$231.8 million of storm-related costs that exceeded PEF's Storm Damage Reserve balance at that time. The surcharge was extended for an additional year through July 2008 to help replenish the Storm Damage Reserve, pursuant to a stipulation approved in Order No. PSC-06-0772-PAA-EI.<sup>6</sup> In total, PEF's ratepayers were charged in excess of \$360 million through the surcharge to recover the Storm Damage Reserve deficiency and to replenish the depleted Storm Damage Reserve balance.

PEF's storm hardening activities are not unusual, extraordinary, or unanticipated. The Company is incurring storm hardening costs pursuant to its own storm hardening plans. These storm hardening costs do not meet the criterion of being related to damages actually caused by storms. In staff's opinion, these storm hardening costs are normal operating expenses that should be included in net operating income, not charged to the Storm Damage Reserve. The actual Storm Damage Reserve balance was \$138.8 million at the end of 2008.<sup>7</sup> It does not appear logical to request authorization to reduce the existing balance by \$33.1 million, or 23.8 percent, in this docket while requesting a \$10 million, or 167 percent, increase in the annual accrual in the current rate case in Docket No. 090079-EI. In addition, the requested \$33.1 million reduction could lessen PEF's ability to cover storm-related damages absent the imposition of an additional surcharge on the ratepayers. Thus, staff does not believe that approving the depletion of the Storm Damage Reserve at the beginning of the 2009 hurricane season would serve to accomplish the goals of mitigating the vulnerability of the state's electric system during extreme weather conditions, which formed the basis for the adoption of the Storm Damage Reserve Rule.

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<sup>3</sup> Docket No. 090079-EI, In re: Petition for increase in rates by Progress Energy Florida, Inc.

<sup>4</sup> See Direct Testimony of Steven P. Harris, prefiled in Docket No. 090079-EI.

<sup>5</sup> Order No. PSC-05-0748-FOF-EI, issued July 14, 2005, in Docket No. 041272-EI, In re: Petition for approval of storm cost recovery clause for recovery of extraordinary expenditures related to Hurricanes Charley, Frances, Jeanne, and Ivan, by Progress Energy Florida, Inc.

<sup>6</sup> Order No. PSC-06-0772-PAA-EI, issued September 18, 2006, in Docket No. 041272-EI, In re: Petition for approval of storm cost recovery clause for recovery of extraordinary expenditures related to Hurricanes Charley, Frances, Jeanne, and Ivan, by Progress Energy Florida, Inc.

<sup>7</sup> See MFR Schedule B-21, Page 3 of 4, filed March 20, 2009, in Docket No. 090079-EI.



Docket No. 090145-EI

Date: June 5, 2009

Based on the above discussion, staff recommends that PEF should not be authorized to charge any of its 2009 storm hardening expenses against the Storm Damage Reserve. If the Commission approves staff's recommendation in Issue 1, this issue is moot.

**Issue 3:** Should PEF's request to create a regulatory asset to defer pension expense be approved?

**Recommendation:** Yes. Staff recommends that only the retail portion of PEF's actual 2009 pension expense, currently estimated to be \$31.5 million, should be deferred as a regulatory asset (2009 Pension Regulatory Asset). On an annual basis, PEF should use any pension expense levels below the allowance provided for in rates in the 2010 base rate proceeding in Docket No. 090079-EI to write-down the 2009 Pension Regulatory Asset. In the event such write-downs are insufficient to fully amortize the 2009 Pension Regulatory Asset, PEF should not be allowed recovery of this item through a base rate case prior to 2015. PEF has agreed it will not earn a carrying charge on this regulatory asset. (Maurey)

**Staff Analysis:**

**PEF's Petition**

In its petition, PEF requests approval to defer \$52.9 million in pension expense. The Company states that this amount is the difference between actual net pension plan income of \$21.4 million for the year ended December 31, 2008, and projected net pension plan expense of \$31.5 million for the year ending December 31, 2009. PEF asserts that the deferral will not involve a change in its retail rates or charges. Further, the Company states that the benefit of the net pension income for 2008 has been recognized and passed on to customers in the interim rate increase calculation in the Company's request for interim relief.<sup>8</sup>

The basis for PEF's request is that unexpected economic conditions have resulted in a significant decline in the fair market value of the pension plan's investments. As noted in the petition, the basic elements of pension expense include service cost, interest cost, expected return on plan assets, and amortization elements, such as the amortization of actuarial gains and losses. The Company notes that it accounts for the costs of the pension plan in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) Statement No. 87, "Employers' Accounting for Pensions," as modified by SFAS No. 158, "Employers' Accounting for Defined Benefit Pension Plans and Other Postretirement Plans." These financial accounting standards require that the pension income or expense be determined, in part, based on a measurement of the fair value of the plan assets as of the end of the previous fiscal year. A decrease in fair market value of the investments results in an increase in pension expense. PEF states that the value of the plan's investments decreased by approximately \$350 million during 2008.

PEF notes the Commission's authorization of the establishment of a regulatory asset as a result of the Company's adoption of SFAS 158 in 2007 was required in order to be in compliance with Generally Accepted Accounting Principles (GAAP). The Company asserts that the decrease in value of plan investments was the result of the severe economic downturn. Because the downturn in the economy was an event beyond its control, the Company contends the deferral requested in this petition should be granted. In support of this position, PEF cites to

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<sup>8</sup> The Commission voted in Docket No. 090079-EI to approve PEF's request for an interim rate increase, In re: Petition for increase in rates by Progress Energy Florida, Inc., at its May 19, 2009, Agenda Conference.

an order of the Public Service Commission of South Carolina that approved an accounting order for regulatory accounting purposes authorizing South Carolina Electric and Gas Company (SCE&G) to defer certain pension costs as a regulatory asset for recovery in a future period.<sup>9</sup>

### Intervenors' Consolidated Response

In their Consolidated Response, the Joint Intervenors object to approval of PEF's request to defer pension expense to a future period. The Intervenors' objection is based on a number of arguments. The Intervenors state that the pension income for 2008 and the projected pension expense for 2009 fall within the period covered by the Stipulation approved in Docket No. 050078-EI.<sup>10</sup> In their opinion, the requested deferral is an attempt to circumvent the express terms of the Stipulation by shifting results of operations from the stipulation period to a future period. In addition, the Intervenors believe that the requested treatment is a violation of the prohibition against retroactive ratemaking in that it would be an attempt to recover past expenses in future rates. The Intervenors also state that the requested deferral would violate the recognition of pension expense specified by SFAS 87, in that pension expense would not be recognized over the approximate service period of the employees covered by the plan. Finally, the Intervenors note that the economic downturn has impacted pension plans across a broad spectrum, including plans of both regulated and nonregulated companies, and as such does not represent an exogenous event unique to PEF.

### PEF's Response to Joint Intervenors' Consolidated Response<sup>11</sup>

In its response to the Joint Intervenors' Consolidated Response, PEF disagrees with the assertion that the requested deferral would constitute retroactive ratemaking because the Company maintains that it has a right to seek limited proceeding rate relief under the provisions of the 2005 Stipulation. PEF states that it is not requesting to defer the 2009 pension expense to the 2010 base rate proceeding, but to some undefined future base rate proceeding. The Company also disagrees with the Intervenors' assertion that the requested deferral would not conform with the requirements of SFAS 87. PEF cites to paragraph 210 of SFAS 87 which "contemplates that regulators may alter the timing of the recognition of pension expense but not the determination of the cost of the pension benefit."

### Analysis

Staff appreciates the concern raised by the Intervenors over what appears to be cost shifting from the stipulation period to some future, undefined period. On its face, it appears that the Company's request is an attempt to track the pension expense in 2009 in isolation.

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<sup>9</sup> Order No. 2009-81, issued February 17, 2009, in Docket No. 2009-36-E, In re: Petition of South Carolina Electric and Gas Company (Electric Operations) for Authorization to Defer Certain Charges to the Company's Financial Statements Resulting from the Impact of Recent Economic Developments on Pension Cost.

<sup>10</sup> Order No. PSC-05-0945-S-EI, issued September 28, 2005, in Docket No. 050078-EI, In re: Petition for rate increase by Progress Energy Florida, Inc.

<sup>11</sup> The Commission's rules do not contemplate a response to a response; however, a response providing additional information was requested at the April 8, 2009 informal meeting, which all parties attended. No objection has been filed to PEF's response.

According to PEF's 2008 10K filing with the Securities and Exchange Commission (SEC), the Company reported a total pension benefit of approximately \$47 million (system) for the years 2006 through 2008.<sup>12</sup> Viewing the four year stipulation period in its entirety, even with consideration of the projected pension expense of \$34 million (system) in 2009, PEF will still enjoy a net pension benefit over the term of the Stipulation.

However, the Stipulation expressly allows PEF to seek an increase in base rates if its achieved or projected ROE falls below 10 percent. The Company has done precisely that in its respective requests for interim relief in Docket No. 090079-EI and for a rate increase associated with the Bartow Repowering Project in Docket No. 090144-EI. At the Agenda Conference on May 19, 2009, the Commission approved approximately \$144 million in rate relief in these two dockets, cumulatively.<sup>13</sup> If not for the \$21.4 million pension benefit in 2008, the amount of the interim rate increase recently approved would have been greater. Moreover, even with approval of the deferral of the 2009 pension expense along with the rate increases previously approved for interim and the Bartow Repowering Project, PEF still projects that it will earn an ROE below 10 percent in 2009. Therefore, pursuant to Section 7, staff does not believe PEF's request in the instant case is prohibited by the Stipulation.

As noted in PEF's petition, the Commission previously approved deferral accounting and creation of a regulatory asset when PEF adopted SFAS 158.<sup>14</sup> In its Order, the Commission stated that:

FAS 71 allows regulated companies to defer costs and create regulatory assets, provided that it is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes. To create a regulatory asset or liability, a regulated company must have the approval of its regulator. This concept of deferral accounting allows companies to defer costs due to events beyond their control and seek recovery through rates at a later time. The alternative would be for the company to seek a rate case each time it experiences an exogenous event.

Staff agrees with PEF that SFAS 158 imposed a specific accounting treatment related to the funded status of pension plans. Staff also agrees with the Company that SFAS 71 does permit the deferral of costs through the creation of a regulatory asset under certain circumstances.

That said, staff does not believe the facts in the instant case are precisely on point with the order of the South Carolina Commission cited by PEF. The South Carolina order expressly

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<sup>12</sup> Florida Power Corporation d/b/a Progress Energy Florida, Inc., Annual Report for the fiscal year ended December 31, 2008 (Form 10K), at 197 (March 2, 2009).

<sup>13</sup> The Commission voted in Docket No. 090079-EI to approve PEF's request for an interim rate increase, In re: Petition for increase in rates by Progress Energy Florida, Inc. and in Docket No. 090144-EI, to approve PEF's request for a rate increase associated with the Bartow project, In re: Petition for limited proceeding to include Bartow repowering project in base rates, by Progress Energy Florida, Inc., at its May 19, 2009, Agenda Conference.

<sup>14</sup> Order No. PSC-06-1042-PAA-EI, issued December 19, 2006, in Docket No. 060674-EI, In re: Petition for authority to use deferral accounting for creation of a regulatory asset in regulatory liability to record charges or credits that would have otherwise been recorded in equity pursuant to balance sheet treatment required by Statement of Financial Accounting Standards (SFAS) No. 158, by Progress Energy Florida, Inc.

states that approval of SCE&G's request for deferral was predicated in part on the South Carolina Commission being able to avoid consideration of a rate case to increase base rates. Since PEF is currently before the Florida Commission with a request for an increase in base rates in Docket No. 090079-EI, PEF's request for deferral of the 2009 pension expense is not directly comparable with the situation in South Carolina. Another difference between the two cases rests with how pension expense has been treated for ratemaking purposes by the respective Commissions. In South Carolina, the revenue requirement approved in 2007 for SCE&G in its most recent rate case expressly recognized an annual pension benefit of approximately \$4 million. This treatment has had the effect of reducing SCE&G's operating and maintenance (O&M) expense, thereby reducing customer rates.<sup>15</sup> In contrast, the order approving the 1993 step increase in base rates for PEF included an annual pension expense of approximately \$3.8 million.<sup>16</sup> This treatment has had the effect of increasing PEF's O&M expense and thereby increasing customer rates. While the South Carolina decision recognized the sum of the annual amount of pension benefit expressly reflected in base rates with the projected pension expense in that same year (2009), PEF's request asks that the pension benefit from the prior year (2008) be added to the projected pension expense in 2009. These two requests are not the same. The Stipulation was silent with respect to pension expense.

While staff agrees with PEF that the Commission has the discretion to create a regulatory asset to defer pension expense, staff questions the calculation of the proposed deferral amount. For the reasons discussed above, staff believes it would be inappropriate to use the sum of the 2008 pension benefit and the 2009 pension expense to determine the deferral amount. Contrary to the position taken by PEF, staff does not believe the \$21.4 million pension benefit from 2008 is embedded in the Company's 2009 revenue requirement. The pension benefit from 2008 has already been booked to income by the Company and is not relevant to the amount of pension expense PEF will incur in 2009. Staff believes the appropriate amount to defer is the retail portion of the actual 2009 expense which is currently estimated to be \$31.5 million.

Finally, staff acknowledges the Company's claim that it is not seeking a change in rates associated with the 2009 pension expense. While the MFRs filed in Docket No. 090079-EI in support of its rate case reflect an annual pension expense of \$27.1 million for the 2010 projected test year, PEF has not included any recognition of the 2009 pension expense in its filing. Moreover, PEF has represented that it will use any pension expense levels below the allowance provided for in rates in the 2010 base rate proceeding in Docket No. 090079-EI to write-down the 2009 Pension Regulatory Asset. In the event such write-downs are insufficient to fully amortize the 2009 Pension Regulatory Asset, PEF states it will not seek recovery of this item through a base rate case prior to 2015. Until that time, the unamortized balance of the 2009 Pension Regulatory Asset will be included in rate base for purposes of Earnings Surveillance Reporting. PEF has also represented that it will not earn a carrying charge on this regulatory asset.

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<sup>15</sup> Order No. 2009-81, issued February 17, 2009, in Docket No. 2009-36-E, In re: Petition of South Carolina Electric and Gas Company (Electric Operations) for Authorization to Defer Certain Charges to the Company's Financial Statements Resulting from the Impact of Recent Economic Developments on Pension Cost, p. 2.

<sup>16</sup> Order No. PSC-92-1197-FOF-EI, issued October 22, 1992, in Docket No. 910890-EI, In re: Petition for a rate increase by Florida Power Corporation, p. 39.

Docket No. 090145-EI

Date: June 5, 2009

Based on its reading of the accounting statements, its understanding of the terms of the Stipulation, and the facts alleged in this case, staff recommends PEF's request to create a regulatory asset to defer 2009 pension expense be approved subject to the conditions outlined above. Thus, staff recommends that the appropriate amount to defer is the retail portion of the actual 2009 pension expense, currently estimated to be \$31.5 million.

Docket No. 090145-EI

Date: June 5, 2009

**Issue 4**: Should this docket be closed?

**Recommendation**: If no person whose substantial interests are affected by the proposed agency action files a protest within 21 days of the issuance of the order, this docket should be closed upon the issuance of a consummating order. (Fleming, Klancke)

**Staff Analysis**: At the conclusion of the protest period, if no protest is filed this docket should be closed upon the issuance of a consummating order.